

THE GOOD AND BAD OF SHORT SALES

By Judith I. Johannsen

What's the big difference between the robust real estate market of just a few years ago and that of today? It's the change in the economy, and because of the national economic slowdown, some local homeowners/borrowers are now unable to pay their monthly mortgage payment, forcing them to sell their homes to get out from under their mortgage debt.

Most homeowners now understand that real property values have decreased (despite higher property assessments and increased property taxes), so the price a property could fetch today is most likely below what it would have sold for just a few years ago. What this can mean to a homeowner who invested little or no money of his own into the property and financed practically the entire purchase is that he may now owe more than the property is worth.

What should an owner who can't meet his mortgage obligation do? First and foremost, he should open the mail his lender keeps sending him. Not opening or ignoring the mail does not make the problem disappear, but it can make it worse. Secondly, he should call his lender to discuss the situation and any options he may have.

What can a lender do for an owner who is behind in his mortgage payments? Some lenders will give an owner "a breather" by agreeing not to enforce (for a specified period of time) the required mortgage payments on their due date. The payments then start up again after this forbearance period and/or the payments skipped could be tacked onto the end of the payment schedule.

A lender could also agree to modify or even refinance the owner's mortgage with terms he can afford, but if forbearance or modification or refinancing won't work, an owner may have to sell the property in order to recoup as much money as possible and hopefully fend off foreclosure.

What if an owner with a mortgage debt greater than his property's estimated market value finds a buyer for his property, but the best offer the seller receives is less than the amount owed? When the proceeds from the closing are insufficient to satisfy the owner's financial obligation, the transaction is said to be "cash poor" or a "short sale".

There is good and bad in a short sale transaction. The immediate "good" is that the homeowner no longer has to pay his monthly mortgage bill, but the bigger chunk of the "good" comes in the form of the federal Mortgage Forgiveness Debt Relief Act of 2007. The purpose of this Act was and is to encourage lenders and defaulting borrowers to refinance loans allowing homeowners to obtain lower mortgage payments without higher taxes.

So, how did taxes get involved? When a lender chooses to accept less money than is owed, it *may* forgive the balance still owing, and under the tax code, the amount of a debt that is forgiven is treated as taxable income to the debtor (because he does not have to pay it back, it theoretically is money in his pocket). Therefore, if a lender forgives a portion of a homeowner's debt, that forgiven debt is considered income to the homeowner on which he would have to pay income tax. The Mortgage Forgiveness Debt Relief Act gives homeowners three years to refinance their mortgages and pay no taxes on any debt forgiveness they receive, and that is a huge "good".

The "bad" is that the owner no longer owns his property and, if the lender were unwilling to forgive that owner the portion of the mortgage debt the property sale did not satisfy, he could still have debt left over from that ownership in the form of a Deficiency Judgment. Today's lenders are wising up, though, in that a short sale can be the quicker, smarter and less costly choice than foreclosure and its attendant costs, and maybe that should be viewed as a "good", too.

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